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USTR FOR BHARMAN

E.O. 12958: N/A
TAGS: EINV ECON ETRD PGOV PE
SUBJECT: PERU: 2006 REPORT ON INVESTMENT DISPUTES AND EXPROPRIATION CLAIMS

REF: STATE 60294

This is Post's response to Reftel, a request for input on outstanding Investment Dispute and Expropriation Claims.

The US Government is aware of seven (7) claims that may be outstanding against the Government of Peru. Since 2004, 4 cases - Claimants D, E, J, and M - have been resolved and should be removed from the report. Post also recommends the removal of 5 cases - Claimants C, F, K, L and O - due to continued lack of involvement by the claimants.

¶1. a. Claimant A

b. 1999

c. Claimant A's Peruvian subsidiary was a major purchaser of Peruvian gold in the late 1990's. In 1999, the GOP issued a decree that made the final purchaser of gold responsible for verifying the legality of the supply chain from mine to export in order to receive the refunds of value-added tax (VAT) allowed under law. On the basis of this decree, applied retroactively, and in the context of a broader investigation into the loss of up to $150 million, the GOP tax authority, SUNAT (Superintendencia Nacional de Administracion Tributaria), charged that claimant's subsidiary had participated in a scheme to defraud the GOP by falsifying gold purchases. SUNAT failed to refund VAT payments and, in December 1999, executed letters of guarantee worth a combined $28 million put up by Claimant A to secure early payment of the refunds. Claimant A denied the accusations and filed an administrative appeal, which was later appealed to Peru's tax court. Subsequently, the GOP filed criminal charges against executives of claimant's Peruvian subsidiary.

On February 4, 2003, the tax court ruled against Claimant A, upholding SUNAT's resolution to withhold the $28 million amount. The tax court ruling did not cite any direct evidence of specific misdeeds by Claimant. However, SUNAT contends that transactions

within Claimant's gold supply chain were simulated and that the company was in a position to know of the irregularities and wrongdoings of suppliers.

Claimant A asserts that GOP corruption caused the execution of the letters of credit and the filing of criminal charges. Claimant A argues that it should not be liable for any possible wrongdoing by its gold suppliers.

The judge in claimant's tax case issued a decision in May 2004 that threw out previous SUNAT and Tax Court rulings against the company. The court found that claimant cannot be held responsible for the irregular actions of third parties and that the GOP improperly seized the company's letters of credit in 1999. The GOP then appealed this decision. The Superior Court, which heard the appeal, issued a split 2-1 decision in March 2005, ruling in favor of Claimant A. However, Peruvian law dictates that the winning side must have a minimum of three votes in its favor. An additional judge was assigned to the case in March 2005. After a hearing in April 2005, the new judge ruled in favor of the GOP, tying the vote at 2-2. A fifth judge has been assigned to the case. The Court issued a 3-2 decision against Claimant A in August 2005.

Claimant appealed to the Constitutional Court. In January 2006, the Constitutional Court ruled 5-1 against claimant. Claimant is considering taking the dispute to the Inter-American Court in Costa Rica.

In the criminal case involving claimant's executives

(lumped together with more than 200 other defendants), the government prosecutor requested that the judge extend the period to investigate the case (adding 60 more days on to an investigative stage that has lingered for 3.5 years). In August 2005, the public prosecutor proposed the dismissal of the case against the claimant's executives. The Court sent the case file back to the prosecutor in February 2006 to amend formal errors before making a decision. In April 2006, the prosecutor resubmitted his recommendation to the Criminal Court to dismiss the case against the Claimant's executives. The Criminal Court will schedule a hearing for August or September, and should issue its ruling by December.

At Claimant's request, Embassy has engaged repeatedly with senior GOP officials since 1999 regarding this case.

¶2. a. Claimant B

b. 1999

c. Claimant B also is involved in a dispute with the GOP regarding the refund of value-added tax on gold exported from Peru between May 1997 and February 1999. SUNAT, the tax agency, has withheld roughly $600,000 that claimant contends it is entitled to receive as a tax refund. The Tax Court issued a decision in Claimant B's case to wait until a parallel criminal case against Claimant B's local general manager is resolved. The company has appealed this decision, arguing that the Tax Court had all the necessary information to make a ruling and that such a position creates undue delay. The Superior Court, which heard the appeal, issued a split 2-1 decision in March 2005 in favor of the government. However, Peruvian law dictates that the winning side must have a minimum of three votes in its favor. An additional judge was assigned to the case and the Superior Court held a hearing on May 24, 2005. The new judge ruled in favor of Claimant B, tying the vote at 2-2. A fifth judge was assigned to the case and the Court held another

oral hearing on June 15, 2005. In August, the Court issued its decision, 3-2 against Claimant. Claimant appealed the case to the Constitutional Court, seeking to overturn the ruling of the Tax Court, which refrained from issuing a resolution until after the criminal case concludes.

The criminal case against Claimant B's local general manager is the same one that involves Claimant A's executives. The Public Prosecutor did not recommend that the case against Claimant B's executive be dropped.

In the September 2002 ATPDEA commitment letter, the GOP pledged to resolve this case promptly, ensuring due process and transparency. In communications with GOP officials, USTR has set progress in the resolution of this dispute as a key factor that will determine whether Peru is included in the potential free trade agreement (FTA) that is sent to Congress.

¶3. a. Claimant C

b. 1989

c. Peru's Supreme Court ruled in December 1989 that ships belonging to Claimant C had been illegally seized by Peruvian Customs in 1985, and that Claimant C is due financial compensation. However, the amount of that compensation is now the subject of a series of court actions involving the Ministry of Economy and Finance

(MEF). MEF contested the legality of Claimant C's claim, stating that the statute of limitations had expired. The court ruled on March 12, 2004, against the company on the statute of limitations issue. Claimant C has appealed this decision to the Superior Court, which was scheduled to start hearing the case by August 2004. An independent legal analysis requested by the Embassy suggested that the lower court ruling was within the bounds of Peruvian law.

Claimant C passed away in early 2005. His wife has since moved to the United States and is no longer seeking Embassy advocacy on this case.

¶4. a. Claimant D

b. 2001

c. This case was resolved in May 2004. Peru's telecommunications agency, OSIPTEL, sponsored competitive bidding for a subsidized, rural telephone network contract in September 2000. Foreign bidders were required to form a consortium with a Peruvian partner. On September 28, 2000, OSIPTEL announced that Claimant D and its Peruvian partner had submitted the lowest bid (about $27.8 million) for a subsidy. The bid submitted by Claimant D and its partner was approximately $10 million less than the second-place bid. OSIPTEL issued an official resolution (a "Buena Pro") declaring Claimant D's consortium to be the winner.

To finalize the contract, Claimant D's partner was required to obtain a concession from the GOP, which the Claimant alleges should have been automatic. The GOP refused to do so, citing indictments against the owners of the Peruvian partner firm. The GOP awarded the concession to the second-place bidder in 2001, allowing the second-place firm to reduce its bid by $10 million to match claimant's bid. Claimant D alleged that the decision to award the concession to the second-place bidder was prompted by that bidder's close contacts with former senior GOP officials. Claimant D alleged that the GOP violated several of Peru's own laws and

regulations.

Working on the basis of guidance from the Department, Embassy officers engaged actively with GOP officials to encourage the GOP to investigate the claimant's allegations and to consider an out-of-court settlement. This case was resolved in May 2004 when Claimant D received a settlement from the second place bidder of $450,000.

¶5. a. Claimant E

b. 2002

c. This case was resolved in 2005. In 1997, the Ministry of Transportation procured a radar system from Claimant E under a turnkey contract. The system became operational in 1998 and, in July 2002, Claimant E sought to close out the contract based upon a satisfactory evaluation of the radar, as mandated by the agreement. The GOP refused to close the contract, arguing that the system did not function properly and that Claimant E had not fulfilled its obligations. In a possible breach of contract, the GOP ordered its bank to collect from a $6 million performance bond posted by Claimant E before negotiations to settle this dispute could begin. That bond drawdown order was stopped by a temporary injunction granted by a New York court in August 2002.

Claimant E and the GOP reached agreement in April 2004 on rules for submitting this dispute to local arbitration in Peru. The parties initiated the arbitration procedures on June 1, 2004. The arbitration panel issued its 3-0 decision on June 16, 2005, in favor of the GOP. Claimant E is paid the GOP $500,000 in damages and the GOP will issue a statement absolving Claimant E from future obligations. The GOP returned the bond to Claimant E.

¶6. a. Claimant F

b. 1999

c. In October 1999, the GOP's forestry and parks authority, INRENA, obtained an emergency decree halting the movement of logging equipment and lumber in several of Peru's jungle provinces. INRENA shut down a logging operation in which Claimant F had invested $2 million and seized lumber intended for export to Claimant F. The GOP alleged that the Peruvian company was engaged in illegal logging. Claimant F denied the charges, asserting that the GOP's actions were intended to put Claimant F's partner out of business. Claimant F and its Peruvian partner have waged a legal battle in Peru against INRENA since then. Claimant F has not sought Embassy assistance since 2002.

¶7. a. Claimant G

b. 1970

c. Claimant G signed an agreement with the GOP in 1953 to build roads in rural Peru in exchange for one million acres of land. Claimant G began developing a first installment of 60,000 hectares, but a military government expropriated the land in the 1960s. Claimant G filed suit. In 1971, the Peruvian Supreme Court ruled that the GOP had to pay Claimant G for the roads he had built.

In its September 2002 ATPDEA commitment letter, the GOP noted that the judiciary had recognized Claimant G's right to indemnity for the road construction, the value of which needed to be determined through further

proceedings. The GOP further pledged to "ensure a transparent and prompt resolution."

In March 2004, the GOP issued a supreme decree establishing a special commission to negotiate a settlement with Claimant G. The commission and Claimant G's attorneys have met three times in Lima, but the two sides failed to agree on a final compensation figure before the mandate of the Commission expired.

Claimant G met again with GOP officials in 2005 to discuss the methodology for establishing the market value price for the work done in 1968. The GOP proposed that Claimant H agree to a new independent appraisal to determine the base amount of compensation. Claimant G agreed in principle, but the GOP refused to compensate Claimant G in one lump sum.

In May 2005, the GOP found an official document from Claimant G in an archived Ministry of Agriculture file that claims the total value of the work completed in 1968 was $865,000. According to the GOP, using a mixture of Treasury bonds and bills, the current-day value would total approximately $10 million. Claimant G asserts that the document was not a complete assessment of work completed.

On March 30, 2006, Claimant G accepted the Peruvian

Government's offer of compensation. The GOP is still working to budgetary approval from the Peruvian Congress.

¶8. a. Claimant H

b. 2001

c. Peruvian tax agency SUNAT served Claimant H in November 2001 with a $49 million tax assessment. SUNAT claimed that Claimant H's local power company under previous ownership underpaid taxes from 1996-1999 due to improper use of depreciation after the privatization of the power company. Claimant H purchased the privatized company in 1999. The power company was privately audited from 1996-1999, and its financial statements for those years were approved by GOP representatives on the company's board and by the GOP privatization agency.

In December 2001, Claimant H filed an administrative claim against the tax assessment. In September 2002, SUNAT upheld its assessment but reduced the amount to $43 million. In late September 2002, Claimant H appealed this decision to the Tax Court. The pending assessment against Claimant H now totals more than $50 million with interest. The Tax Court issued in May 2004 a decision disagreeing with the method of depreciation employed by the company and asking SUNAT to recalculate its assessment. Parallel to these legal proceedings, Claimant H and the GOP submitted this case to international arbitration in 2004. Claimant H argues that SUNAT's reassessment violates a Legal and Tax Stability Agreement between Claimant H and the GOP.

This case is pending a decision in international arbitration.

¶9. a. Claimant I

b. 2003

c. In December 2003, tax agency SUNAT assessed Claimant I $9 million in fines and reduced its income tax credit for 1998 from 32 million Soles (Peruvian currency) to 9 million Soles. The assessment was based on SUNAT's claim that

Claimant I's 1997 merger with a local metal refining company had no economic substance. Claimant I believes the merger was done correctly and that its receipt of applicable tax benefits was in strict compliance with existing Peruvian law. Claimant I contends that the economic substance of the merger has been clearly demonstrated. In December 2004, SUNAT, after reviewing Claimant I's 1999-2001 income taxes, assessed the company with additional fines. As of December 31, 2005, Claimant I's tax liability for the 1998-2001 assessments was estimated to be more than $110 million.

In February 2006, Claimant I hired CONATA, the Peruvian state-owned appraisal agency, to evaluate 10 percent of the company's holdings as a test. The results were lower than Claimant I's own appraisal by 30 percent. According to Claimant I, the CONATA appraisal valued the company's assets individually (as one would do in a liquidation) rather than as part of an integrated profitable enterprise. Claimant I in May 2006 requested that CONATA conduct an integral assessment.

There is also a growing backlog of VAT refunds due to Claimant I, dating from mid-2004. In September 2004, as a result of Claimant I's request for a VAT credit, SUNAT conducted a full audit of the company's January-July 2004 tax documents, inquiring why the company did not pay VAT on some zinc and copper sales. In November 2004, SUNAT assessed that Claimant I owed more than

$2.2 million in back VAT payments and offset this amount against the refund for VAT credit. SUNAT then began an audit of Claimant I's VAT documents dating from 1999-2001. As of December 31, 2005, the company has an assessed VAT liability of $44 million for the years 1999-2001. In January 2006, SUNAT began another tax audit of Doe Run, this time for the 2002-2003 period. This audit is still in process. While the audits continue, SUNAT refuses to grant Claimant I's credit on VAT refunds, which total more than $100 million.

¶10. a. Claimant J

b. 2001

c. This case was resolved in September 2005. Claimant J is a local power company majority-owned by two US energy companies. Claimant J signed a ten-year legal and tax stability agreement with the GOP in 1994. Tax agency SUNAT disputed the company's continued use after 1999 of accelerated depreciation, which was permitted under Peruvian law for companies that underwent reorganizations. The issue initially went to arbitration and a parallel Tax Court proceeding. Claimant J won in both instances, but SUNAT was permitted to revisit the case. In July 2003, SUNAT assessed claimant with $56 million in back taxes due since 1999. Claimant J again appealed the SUNAT assessment to the Tax Court, which ruled in February 2004 that Claimant J had a right to revalue assets and that there should be no assessments for the years 1996-¶1998. The Tax Court, however, asked SUNAT to review the 1999 assessment again; SUNAT concluded Claimant J overvalued its assets to reduce its tax burden.

After another appeal by Claimant J, the Tax Court in late January 2005 directed GOP agency CONATA (a state-owned valuation firm) to conduct a new assessment of Claimant J's 1994 assets. The Tax Court issued a ruling on July 26 instructing SUNAT to utilize the CONATA assessment to resolve the dispute. SUNAT determined that Claimant J owed approximately $282,000 in back taxes and interest through 1999. The company paid the amount in September 2005. SUNAT also agreed to not appeal the Tax Court decision that prevented the agency from reopening the 1996-1997 tax years.

¶11. a. Claimant K

b. 1970

c. Following receipt of a letter from Congressman Silvestre Reyes (Texas) concerning Claimant K's case in December 1999, Embassy received a letter from Claimant K in February 2000 and met with claimant at his request while he was visiting Peru in May 2000. According to Claimant K, in about 1970, Peru's military government expropriated his farm as part of a general land reform act that expropriated farms over 250 hectares. Claimant's farm, however, is just under 200 hectares. Claimant K was issued compensation bonds, which have since become worthless as the result of hyperinflation. Claimant K asserts that, because he believed the expropriation to be illegal and because he was living in the United States at the time, he made no attempt to redeem the bonds. Claimant K has provided no estimate of the land's current value, maintaining that his goal is to have it returned.

Claimant K began efforts to recover his farm in 1999. At Embassy's suggestion, he joined an association composed of others whose land was expropriated. Claimant K has also contracted legal counsel in Peru,

but has not separately pursued remedies through the Peruvian courts.

Embassy Officers met with Claimant K in 2000, and were in contact with Claimant K on one occasion in 2001. Embassy officers have requested details on the expropriated property, a timeline of events related to the expropriation, and any legal analysis supporting the Claimant's assertion that the expropriation did not comply with Peruvian law. To date, Embassy has not received this information. Post has had no contact with claimant since July 2001.

¶12. a. Claimant L

b. 1976

c. According to Claimant L, pursuant to the Agrarian Reform Law, the Peruvian Agriculture Ministry (MinAg) in 1976 transferred about 60 hectares of land he had purchased in 1964 to the Comunidad Campesina de Oyon (CCO), located in the district and province of Oyon in the department of Lima. MinAg allegedly did so without his knowledge and without notifying him of the action.

Claimant L hired a lawyer to undertake administrative procedures for recovering his land in 1976, but the claim was lost, and in May 2000 MinAg found that his claim had no merit. He appealed administratively and also received a letter in November 2000 from the Huaura Superior Court indicating that the GOP's General Office of Agrarian Reform had mistaken him for another landholder with a similar name. Simultaneously, Claimant L filed suit against local mining firm Buenaventura, which Claimant L asserts took advantage of the title dispute to cut down all of the trees on what was wooded land. Claimant L also says that the dispute led to threats against him from the CCO, and that terrorist activity in the area prevented him from returning to his land until 1990.

Claimant L sent Embassy documents in November 2000 related to the alleged expropriation of his land. At Embassy's request Claimant L provided a brief letter laying out the facts of the case in March 2001. Embassy forwarded this letter to MinAg, with a request that it be given appropriate attention. The Ambassador received a letter dated May 6, 2002 from MinAg, confirming that the land had been transferred under the

agrarian reform program to the CCO on June 19, 1976, and that title had been confirmed to the CCO on November 8, 1982. MinAg asserts that, as a result, Claimant L only has a right to claim the fair market value of the land, and must pursue this through the courts.

Claimant L has not contacted the Embassy for assistance since 2002.

¶13. a. Claimant M

b. 2001

c. This case was resolved in January 2006. Claimant M entered into a consulting services agreement with PRONAP (now PARSSA) to provide design services for potable water supply and wastewater system. During the performance of the contract, Claimant M performed additional work at the direction of PRONAP but has yet to receive payment. Claimant initiated arbitration in June 2001 in order to recover the costs of this additional service. In March 2004, the arbitration panel found in favor of Claimant M and ordered PARSSA to pay approximately $1.5 million. PARSSA disagreed

with the arbitration decision, claiming that the arbitration panel was neither independent nor impartial, as PARSSA was not involved in the process of determining the arbiters. PARSSA appealed to the Judiciary in April 2004, requesting an annulment of the arbitration decision.

In August 2005, the Judiciary issued its ruling in favor of Claimant M, denying a GOP appeal to reject the binding arbitration. The court ordered PARSSA to pay the amount owed, which with interest could total approximately $3 million. On September 2, the Ministry of Housing appealed the August ruling in favor of Claimant, claiming there were irregularities in the handling of the arbitration case. Claimant formally appealed the submission of the case in October 2005, citing a mid-July Supreme Court Directive that instructed the Judiciary to not overturn arbitration decisions.

After Embassy advocacy on Claimant's behalf, the company received a $1.9 million partial payment for its arbitration award on December 23. In early January, Claimant received a second payment of $600,000. Claimant M and the GOP continue to negotiate the final payment of the remaining $141,000 in legal fees.

¶14. a. Claimant N

b. 2004

c. According to the Claimant, SUNAT announced in October 2004 that it was levying taxes for fuel supplied to outbound international carriers and would be collecting these taxes on sales (IVG) for the past four years (2000-2004). For Claimant N, these back taxes amounted to $15 million.

The GOP, in an effort to resolve the problem, passed a new tax law in January 2005 that classified future sales of fuel for international transport (air and sea) as exports, exempting the sales from IVG. The law, however, failed to make the tax exemption retroactive. The Ministry of Finance, working with Claimant N, drafted an amendment to the new tax law that would retroactively grant companies an IVG credit for previous sales of fuel for international transport. The Peruvian Congress voted in favor of this law in October 2005.

While the Congress passed the law, SUNAT claimed that it was not retroactive and therefore Claimant N could not claim a credit on its $15 in back taxes. To rectify the situation, the Ministry of Finance is drafting a regulation to be passed by Congress to allow for retroactive credit of the back taxes.

¶15. a. Claimant O

b. 2000

c. Claimant provides telecommunications services over the world's first integrated global Internet protocol based network and has deployed a sub-sea fiber optic network around South America. The submarine fiber and transmission equipment sit on the ocean floor more than 12 nautical miles from shore, except where a cable system lands in a country to connect that country to the worldwide network.

Tax agency SUNAT conducted an assessment of Claimant O's assets. Per SUNAT's request, Claimant O paid customs duties and VAT on all goods imported into Peru, including for equipment extending 12 nautical miles

from Peru's coast. In November 2000, SUNAT re-assessed Claimant O's property and imposed $43 million in additional duties and VAT, based on an assessment of equipment located between 12 and 200 nautical miles from the coast of Peru. Claimant O has appealed the reassessment.

Claimant O has not contacted the Embassy for advocacy since 2005.

Note: In 2003, a Singaporean Company purchased Claimant O, but Claimant maintains its headquarters in the United States. Post advocated on behalf of the company based on US national interest.

¶16. a. Claimant P

b. 1996

c. Claimant P purchased an existing light manufacturing facility in 1994 and began operations the same year. Although the company complied with all district regulations and received all necessary permits, the city of Lima, the governing municipality, continues to refuse to finalize the permitting and registration process for the facility on the grounds that it is located in an environmentally sensitive area.

Claimant presented its permits and details of the plant to the District Government on June 6, 2005. The district government has one month to make a decision. Once it makes a decision, it will forward the paperwork to the Lima Provincial Government for its consideration.

If the Municipal Government refuses to recognize the Claimant's permits, the company could be forced to move, which would cost approximately $3.7 million.

¶17. To our knowledge, none of the following have signed Privacy Act Waivers. The companies are as follows:

Claimant A - Engelhard
Claimant B - Princeton Dover
Claimant C - Big 3 Marine
Claimant D - STM Wireless
Claimant E - Northrop Grumman Corporation
Claimant F - Newman Lumber
Claimant G - Mr. Roy LeTourneau, U.S. Citizen

Claimant H - Duke Energy
Claimant I - Doe Run
Claimant J - Luz del Sur
Claimant K - Dr. Jaime Muro-Crousillat, U.S. Citizen
Claimant L - Mr. Manuel A. Vizurraga, U.S. Citizen
Claimant M - Parsons
Claimant N - Exxon Mobil
Claimant O - Global Crossings
Claimant P - Kimberly Clark

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